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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 673

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ESTATE OF HERMAN J. BOSCH, DECEASED,
IRVING TRUST COMPANY, Executor,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

Question Presented

When a question of State law comes in issue in a federal tax controversy and a State court of highest original jurisdiction, whose decisions are reported and have precedential value, has, after independent consideration, determined the character of a property interest owned or transferred by the decedent, which binds the parties to its judgment, is a federal court bound by that decision?

Statement

Herman J. Bosch, a resident of New York, died on April 6, 1957. He had created a revocable trust in 1930, which, as amended in 1931, directed that the income be paid to his wife during her life and granted her, but only if she survived him, a general power of appointment. In default of appointment, the trust provided that half the corpus was to go to her heirs and half to decedent's heirs then living. In 1951, in order to allow her to exercise the power after the decedent's death without causing the corpus to be taxed as part of her gross estate at her death, decedent's wife executed an instrument which purported to release her general power of appointment and to convert it into a special power of appointment.[1] (R. 4, 27-31, 33-34, 36, 37-38, 39-40.)

Decedent's executor claimed a marital deduction for the value of the trust ($70,222.04). This trust would qualify for a marital deduction only if, at the time of the decedent's death, his widow had possessed the right to receive the income from the trust for her life and a general power of appointment over the corpus of the trust. It would not qualify for the marital deduction if she had only the right to the income plus a special power of appointment. Internal Revenue Code of 1954, §2056(b)(5). In view of the widow's purported prior release of her general power of appointment, the Commissioner deter-

1. In respect to powers created on or before October 21, 1942, if a person exercises a general power of appointment over a trust, the trust assets are included in his or her gross estate. The exercise of a special power of appointment does not cause such an inclusion. If the general power is not exercised, no inclusion results. Internal Revenue Code of 1954, §2041(a)(1). Petitioner has apparently confused these rules with those applicable to powers created after October 21, 1942. (Footnote 1, p. 3; Petitioner's brief)

mined that the *inter vivos* trust corpus did not qualify for the marital deduction. The executor filed a petition in the Tax Court for a redetermination of the resulting deficiency (R. 3-6, 7).

The Tax Court controversy turned on whether the 1951 release by decedent's widow was invalid. In the event it was, she would still have possessed a general power of appointment at the time of her husband's death in 1957, and the trust would qualify for the marital deduction. While the Tax Court proceeding was pending, the trustee, who also is executor of the decedent's estate, filed a petition in the New York Supreme Court for approval of its intermediate account. No accounting had previously been made for the 33 years in which the trust had been in existence. In connection with the proceeding, a determination of the validity of the widow's attempted release in 1951 was requested. The Tax Court, with the Commissioner's consent, continued the Tax Court proceeding pending the outcome of the action in the State court (R. 1-2, 23, 41-43). Judge Friendly notwithstanding, a determination of the issue was necessary in the State court to bind all parties to the proceeding; it was the only way to fully protect the trustee. The court held, in a published opinion, that the release was a nullity (R. 10-11, 14-15, 45-47).

The Tax Court accepted the State trial court decision "as an authoritative exposition of New York law and adjudication of the property rights involved" (R. 24), and allowed the executor a marital deduction for the value of the assets of the trust. The court of appeals affirmed, Judge Friendly dissenting. The majority held that the New York judgment authoritatively settled the rights of the parties, not only for New York, but also for purposes of the application of the federal tax laws to those rights.

SUMMARY OF ARGUMENT

Petitioner's rule that the federal court is bound only in an adversary proceeding is difficult of application. It would require in each instance an extensive examination of the record in the trial court to determine whether or not an adversary proceeding had taken place. Further, it puts an extremely difficult burden upon the federal courts which, in addition to determining whether or not the State court proceeding was adversary, must then determine State law.

Respondent concedes that the federal fisc should not be bound by all State court determinations. Obvious examples include non-adversary determinations of factual matters, consent decrees, and instances where the State court determination could itself be collaterally attacked, e.g., where fraud is present.

The federal fisc is bound by an authoritative decision by a State court, i.e., where a State court has made an independent determination of a question of State law which has been regularly submitted to it for its decision.

This court has held that a non-adversary decision binds the federal fisc where it is the result of an independent determination by a State court of competent jurisdiction.

The issue before the State court involved the releasability of a general power of appointment at a time when that power could not be exercised under State law. No New York State court had determined this issue; it was a question of first impression.

I.

PETITIONER'S PROPOSED RULE IS DIFFICULT OF APPLICATION AND WOULD OFTEN WORK UNFAIR RESULTS.

The petitioner has proposed that the sole criterion for determining whether a federal court should be bound by a State court decision is whether the proceeding in the State court was adversary or non-adversary. He proposes that if the State court proceeding was adversary, the federal court should be bound, even though the result of the State court proceeding was contrary to state law. On the other hand, if the State court proceeding was non-adversary, the federal court would not be bound and would be required to make its own determination of State law and its application to the facts of the case. There are several obvious objections to the rule.

First, petitioner's rule would require a federal court to examine the record in the State court to determine whether the positions taken by the parties were in fact adversary. It is suggested that it is not always easy to determine when a litigation is adversary.

The petitioner suggests no definition of what is an adversary determination. Is a single voice raised in objection to the ultimate determination, but without detailed documentation or argument, sufficient? Would the federal court be required to examine the briefs to determine if the arguments against the ultimate determination were too weak? Would mere ineptness on the part of the unsuccessful counsel before the State court be sufficient to make the proceedings non-adversary? If so, what degree of ineptness? Would the federal court be required

to have a trial on the issue of whether, for example, the failure to cite a controlling precedent was mere neglect or evidence of the non-adversary nature of the proceeding?

It is submitted that the petitioner's proposed subjective test could result in even more uncertainty on the part of litigants in federal tax cases than is now the situation under the conflicting standards imposed by the various Courts of Appeal.

Second, there are many determinations by State courts which are "non-adversary", particularly if, as suggested by the Commissioner, one must appeal to make sure it is adversary. Petitioner's rule would, therefore, impose a great burden on the federal courts, in initially determining when it was not bound by a State court determination because of some undefinable degree of non-adversariness, and, then, in ruling on State law. Thus the already overburdened federal courts would be additionally and unnecessarily burdened.

Third, the petitioner's rule would not give effect to the many legitimate State court determinations made in a non-adversary context. The instant case is an illustration of a legitimate determination. The trustee had not filed an accounting since the trust had been created 33 years before. Once the controversy over the validity of the release by the decedent's widow of her general power of appointment had arisen, it was only by raising the issue in connection with a petition for approval of an accounting that the trustee could secure an adjudication that would determine the issue as to all parties interested. Only the Commissioner and the executor would have been bound by the Tax Court determination. In this way, the trustee could rely on the adjudication to protect itself after the death of the donee should she appoint outside

of the class as limited by the purported release. The donee could draw a will disposing of her property, secure in the knowledge that her exercise of a general power of appointment would be given effect.

Many State court proceedings arise in a non-adversary context. This is frequently true in the determination of property rights between members of a family. This is in no way sinister, as the petitioner seems to suggest. Parties may quite properly wish to receive no less than that to which they are legally entitled, and simply desire an authoritative, albeit non-belligerent, determination of their legal rights. They should not be prevented thereby from seeking recourse to a State court for resolution of questions of State law. (A State judge is better equipped for such a resolution than the federal courts because of the greater frequency with which he deals with State property rights.) Nor should they be forced to the expense of an appeal.

In the usual case, rights added to one party are taken from another. In such cases the petitioner's suggested rule would work a hardship upon the losing party to the State court proceeding. Petitioner states that, "The losing party in a non-adversary State proceeding has no real complaint if the federal court concludes that he should have won, since he voluntarily relinquished rather than asserted his rights in the State court" (Brief for Pet., pp. 25, 26). The conclusion does not necessarily follow from the premise. A party may be willing to have his rights determined without going to the expense of having a brief prepared in his behalf, but not be willing to lose and then be taxed as if he had won. Petitioner's rule would force a reluctant party to actively litigate an issue (perhaps even appeal an adverse decision) at the peril of being taxed on that which he did not possess.

Fourth, due deference to State court decisions is desirable to avoid an unnecessary intrusion by federal courts into the decisional law of a State. Operation of the petitioner's mechanical non-adversary rule could have the consequence in the instant case of the development of two interpretations of §183 of the New York Real Property Law, one in the federal courts and one in the New York courts. The federal courts should decide questions of State law only when compelled to do so because of the absence of an authoritative determination by a State court.

II.

NOT ALL STATE COURT DECISIONS SHOULD BE FOLLOWED.

Despite the desirability of adherence to State court decisions, respondent concedes that not all such decisions should be conclusive against the federal fisc. Thus, effect should not be given to fact-finding by a State court, particularly in a non-adversary context. The State court will not be aware of evidence withheld from it by the parties; a State court judge has no independent fact-finding apparatus. He can, however, make an independent determination of the law by reference to statutes, reported cases and commentaries. Nor should a determination be followed which purports to have a *nunc pro tunc* effect As was said in *Daine* v. *Commissioner*, 168 F. 2d 449, 452 (C.A. 2), "No sovereign is likely to permit its revenue to be set at naught through such retroactive manipulation of state judicial proceedings." See also *Straight's Trust* v. *Commissioner*, 245 F. 2d 327 (C.A. 8). Respondent also agrees that State court determinations which can be suc-

cessfully collaterally attacked for fraud or lack of jurisdiction would also not be binding.

Apart from these sorts of cases, which are by no means exhaustive and are cited only by way of illustration, authoritative State court decisions should bind the federal courts.

III.

THE ELEMENTS OF AN AUTHORITATIVE STATE COURT DECISION.

Respondent respectfully submits that an authoritative decision is one in which an independent determination by a court of competent jurisdiction has been made of the issues regularly presented to it. Indicia of such an independent determination would include the following: (a) appearances by all interested parties including guardians *ad litem* for infants or incompetents; (b) oral argument or submission of briefs; (c) necessity of determining the particular issue, so that its disposition will not be *obiter;* (d) serious attention in a published opinion of the court to the pertinent issue, so that it shall not have been disposed of merely *en passant;* and (e) publication for precedential value of the State court decision. Certainly, *Bosch* qualifies as an authoritative decision.

An independent appearance was made by a guardian *ad litem* for Peter Bosch, an infant who is one of the presumptive remaindermen. Three briefs were submitted, one by the guardian, one for the widow of the decedent (the donee of the power of appointment) by her own attorney, and one for the trustee by its attorneys. The opinion in the New York Supreme Court discussed the issue in detail, with citation of cases. The issue was

regularly raised by the petition of the trustee, in connection with a request for an approval of an accounting. Decisions of the Supreme Court of the State of New York represent legal precedent throughout the State, unlike decisions of local courts with limited geographical jurisdiction whose decisions are not precedents for other courts of the state. "• • • [T]he Supreme Court is a single great tribunal of general state-wide jurisdiction, rather than an aggregation of separate courts sitting in the several counties or judicial districts of the state," *Schneider* v. *Aulisi*, 307 N. Y. 376, 381, 121 N.E. 2d 375, 377 (1954).

IV.

THIS COURT HAS HELD THAT A FEDERAL COURT IS BOUND BY A NON-ADVERSARY STATE COURT DETERMINATION.

The petitioner in this case has argued that the criterion for the binding effect on a federal court of a State court's determination of property rights is whether the State court proceeding involved adversary positions taken by opposing litigants. The proposition has been presented by the government and adopted by various federal courts that the absence of adversary positions among the parties before the State court constitutes "collusion" in securing a decision by such court which would adversely affect the Government's right to additional tax. In support of this proposition, this Court's decision in *Freuler* v. *Helvering*, 291 U. S. 35 has been repeatedly cited.[2] In

2. *E.g.*, *Peyton's Estate* v. *Commissioner*, 323 F. 2d 438, 444 (C.A. 8); *Faulkerson's Estate* v. *Commissioner*, 301 F. 2d 231, 233 (C.A. 7), *cert. denied* 371 U. S. 887; *Stallworth's Estate* v. *Commissioner*, 260 F. 2d 760, 763 (C.A. 5).

order to determine whether this reliance upon the *Freuler* decision is appropriate, an analysis of the background of that case and of this Court's decision is in order.

The facts in the *Freuler* case were that the trustee of a trust, whose assets consisted in part of real property, had made annual distributions to the income beneficiaries without withholding from such income any amount to cover depreciation on the property involved. When the Commissioner of Internal Revenue sought to tax the income beneficiaries upon all the income they had received without allowance for depreciation, the trustee of the trust filed an account in the State trial court having jurisdiction, showing the payments made to the income beneficiaries. Objections to the account were filed by the remaindermen of the trust that the trustee should have withheld from income distributed amounts equal to the depreciation on the trust property.

The trustee's answer to this objection was as follows (Freuler, Record on Appeal, pp. 127, 128):

> "Admits the allegations in paragraph 2, and in his behalf alleges that the disbursements made in said fourteenth account were made without deduction of reserves or other provision for the depreciation mentioned in said paragraph, under and pursuant to the advice of counsel learned in the law retained by said trustee, to the effect that under and by virtue of the terms of said trust it was the duty of said trustee to make such disbursements without such deduction; that said trustee does not know now whether said advice was correct or not, and prays that this Court may decide upon the correctness of said claim so advanced by objectors herein, for the future guidance of said trustee; that by reason of the fact that these payments have been made for many years without objection, in good faith and on the advice of coun-

> sel, it is neither fair, just nor equitable that said trustee be charged on account thereof, save and except to the extent that trustee may be able to reclaim from the recipients of said disbursements such amount as the Court may hold to have been erroneously paid to them."

On the basis of this record the State court determined that income should have been retained by the trustee to cover depreciation, but that the trustee should not be surcharged for such failure and ordered the income beneficiaries to repay to the trusts the amounts so erroneously distributed.

The Government, in its brief before this Court, in *Freuler,* characterized the State court proceeding in the following language:

> "In the preceding argument it has been assumed that the decision of the State court in this case represented an actual adjudication of the question involved. The inference that it was not such an adjudication, however, seems irresistible. A consideration of the facts shown by this record make it plain, we contend, that the order of the State court was nothing more than a friendly settlement without any real contest, and requires the inference that the primary, if not the sole, object of the proceeding was to establish a basis for a deduction of depreciation for Federal income tax purposes. There was, of course, practically, such a community of interests that the apportionment of depreciation was largely a matter of indifference except as it might affect Federal tax liability."

The petitioner, at page 10 of his brief, interprets this Court's opinion in *Freuler* by saying:

> "This Court's decision in *Freuler,* clearly implied that a State trial court proceeding in which 'all

> the parties joined in a submission of the issues and sought a decision which would adversely affect the Government's right to additional income tax' would not be conclusive for federal tax purposes."

The excerpt which he quotes from the *Freuler* opinion is not this Court's statement of the circumstances which would preclude conclusive effect being given to the State court's determination, but was an exposition of the position urged by the Government in that case. This Court's statement of the criteria to be applied is set forth (291 U. S. p. 45) immediately following the portion quoted by the petitioner, where it said

> "The case appears to have been initiated by the filing of a trustee's account, in the usual way. Notice was given to the interested parties. Objections to the account were presented, and the matter came on for hearing in due course, all parties being represented by counsel. *The decree purports to decide issues regularly submitted and not to be in any sense a consent decree.*" (Emphasis supplied.)

A striking illustration of the non-adversary character of the State court proceeding in *Freuler* is the settlement made. The life beneficiaries made restitution of the amounts improperly paid them because of the trustee's failure to make a reservation for depreciation. Notes were given payable to the remaindermen, but only at the termination of the trust. Co-makers on the note given by one of the life beneficiaries were the two presumptive remaindermen who had originally filed their objections in the State court (*Freuler*, Record on Appeal, p. 145). Nor could this Court have been unaware of this, since it is referred to in Justice Cardozo's dissent (291 U. S., p. 48).

The background in *Blair* v. *Commissioner*, 300 U. S. 5, is strikingly similar to that in both *Freuler* and the

present case—the submission of a question of construction to a local court with only one side of the issue affirmatively presented. The only difference in *Blair* is that the State trial court, in making its independent determination, disagreed with the sole affirmative presentation made to it. On the appeal from its decision, again only one side of the argument was presented to the appellate court which reversed the trial court. The background of that proceeding was characterized by the Court of Appeals, 83 F. 2d 655, at p. 657 in the following terms:

> "We would be better satisfied if the suit in that state court had been more adversary in its nature. There is that which suggests a friendly suit to avoid taxes, to which there was no opposition or adverse party. All who joined in the litigation were desirous of obtaining the same end—the avoidance of a large part of the Federal income tax through division of the income by the beneficiary among his children. The Government was not a party to that suit. The suit was prosecuted only until a favorable decision was reached and then no appeal was taken."

With full awareness of the facts underlying the State court determination in *Blair,* this Court concluded (300 U. S. 5, at p. 10) that it was bound by such determination, the State court having

> "* * * reviewed the decisions of the Supreme Court of the State and reached a deliberate conclusion. To derogate from the authority of that conclusion and of the decree it commanded, so far as the question is one of state law, would be wholly unwarranted in the exercise of federal jurisdiction."

From the foregoing, it is apparent that the standard which has been applied by this Court is not whether the

State court proceeding was adversary or non-adversary, but, rather, whether an issue was regularly presented to the State court for its independent determination, resulting in a deliberate and considered conclusion, resolving the issue.

In view of the petitioner's repeated citation of *Erie R. Co.* v. *Tompkins,* 304 U. S. 64, a word should be said about its applicability to this case.

The basic difference between the doctrine of the *Erie* case and the doctrine of *Freuler* and *Blair* relates to whose and what property rights are the subject of the federal court action. Where the specific property rights of the taxpayers involved in the federal tax litigation have been fixed by the independent and considered determination of a State court, *Freuler* and *Blair* dictate that the federal court may look no further and is bound by the State court's determination. If, however, the specific property rights of the taxpayers have not been so determined by the State court so that the federal court must make its own determination of state law and the application thereof to the facts before it, *Erie* lays down rules as to what weight the federal court should give to various State court decisions in making that determination.

Thus, in this case, *Freuler* and *Blair* dictate that the federal court is bound by the State court decision on the property right in issue. If the taxpayer here was one whose rights had not been determined, then presumably *Erie* would apply.

V.

CONGRESSIONAL INTENT.

Petitioner cites Treasury Regulations §§20.2053-1(b)(2) (T.D. 6296) and 20.2056(e)-2(d)(2) (T.D. 6296) and certain language in Senate Report No. 1013, Part 2, 80th Cong., 2d Sess. (1948-1 Cum. Bull. 331, 334) as evidence that Congress intended that a federal court not accept a determination in a non-adversary context (Brief for Petitioner, pp. 8, 16-18, 22, 28). Both passages in the Regulations state that non-adversary proceedings will "not necessarily" be accepted. This is fully consonant with this Court's acceptance of certain non-adversary determinations in *Blair* and *Freuler* and respondent's suggested rule. The Regulations clearly suggest that certain non-adversary proceedings *will* be accepted. The bare statement in the Senate Report that bona fide adversary proceedings will be accepted (which no one disputes) casts little light on what non-adversary proceedings will be unacceptable.

VI

THE QUESTION BEFORE THE STATE COURT WAS A MATTER OF FIRST IMPRESSION.

The question before the State court in this instance involved the meaning of the language in Section 183 of the New York Real Property Law. This section provided that "[a]ny power which is exercisable * * * by deed or will, or otherwise * * * is releasable * * *". The basic problem in the Bosch matter was that at the time of Mrs. Bosch's purported partial release of the power, it could not have been exercised by her in any way, even by her will had

she died at that moment, by reason of the fact that the power was expressly not exercisable by her unless she survived her husband who was then still living.

The petitioner cites *In the Matter of Woodcock,* 19 M. 2d 268, 186 N.Y.S. 2d 447 (Surr. Ct., Westchester Co.) as controlling authority in the Bosch case and criticizes the New York Supreme Court for its failure to refer to that case. However, in *Woodcock,* the power of appointment involved was presently capable of exercise at the moment of its partial release, so that the case was wholly inapposite where the court's determination was based upon an interpretation of Section 183 that a power must be presenty capable of being exercised in order for it to be released.

All of the other cases cited by petitioner on page 35 of his brief contain the same distinguishing feature—the power in each was capable of being exercised at the time of its release. In fact no case presenting a similar set of facts under New York law has been found. For this reason the question before the New York Supreme Court was one of first impression.

Section 146 of the new Article 5 of the New York Real Property Law, cited by the petitioner (Brief for Petitioner, p. 35, footnote 29) and Judge Friendly below (363 F. 2d, p. 1017, footnote 4), makes it clear that §143 (the present version of old §183) allows the release of powers not presently exercisable. However, §143 is a revised version of old §183. The wording was changed from "Any power *which is* exercisable * * *" to "Any power, *whether* exercisable * * *" (emphasis added). The implication is that the legislature found it necessary to so revise the wording of old §183 in making a general revision of the statute to extend it to powers not presently exercisable.

CONCLUSION

FOR THE REASONS STATED, THE JUDGMENT BELOW SHOULD BE AFFIRMED.

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